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Introduction and Plan of the Study

Concepts and Characteristics of Middleman Trade

To understand some of the major international economic problems we need to know more about the role of the middleman in world trade. An international middleman, as I use the term, is a resident of a third country who assumes control, beyond that of carrier or financial agent, of a commodity moving between the country of production and the country of consumption. Three types of middlemen can be recognized: the merchant, the agent, and the multinational producer. The merchant buys and sells on his own account goods produced by others; this category also includes concerns which call themselves "brokers" and "agencies" but carry out the merchant's function. The agent represents either the producer, the consumer, or a third party. In principle it is desirable for many purposes to exclude from the middleman category agents who are subordinate to one of the other three; in practice difficulties must be dealt with as they arise in distinguishing between a middleman and a subordinate agent. Commission merchants are included under agents. Multinational producers, best typified by the petroleum industry, maintain branches and subsidiaries in foreign countries.

Multinational producers are clearly not middlemen in the same sense as merchants. The difference is, however, merely a matter of degree. Instead of purchasing a finished product from residents of the country of production, the multinational producer pays a considerable part of the cost of production as rent, taxes and royalties, wages and salaries for services of residents of the country of production. Thus, when the multinational producer then sells the product to residents of a third country, his activities become quite similar to those of the merchant engaged in merchandise transactions abroad.[1] Purchases by third countries of com-

[1]For national income accounting the approach followed by the International Monetary Fund (*Balance of Payments Manual, 1950*) may be useful. Nevertheless, its assumption that foreign branches and subsidiaries are residents of the country of production, and also that international transactions as well as production are handled by the foreign branches and subsidiaries, with the parent company receiving only profits or interest, introduces into balance of payments accounting a fiction that dealings are at arm's length. Such a picture of international economic relations may be misleading, particularly where — as is certainly true for petroleum companies and probably the case for most other multinational producers — the international transactions are handled by the parent company.

modities moving in free transfer from country of production to country of consumption comprise an additional type of middleman activity of some significance under offshore procurement programs associated with postwar foreign aid. But, unless otherwise stated, this discussion will be limited to middleman activities involving commercial transactions with residents of the country receiving the commodities. The common aspects of middleman activities can, perhaps, be most easily recognized by use of the term "indirect trade," whether or not involving consignment to an agent. Indirect trade, therefore, includes that part of merchandise, moving directly from country of origin to country of consumption, which falls under control of a resident of a third country, as well as that part moving through country of consignment to country of destination. All other international trade I call "direct trade."

From these definitions it follows that, where international trade involves a middleman, residents of the country of consumption make payment not to the country of production but rather to a third country.[2] An example of the particular significance of such transactions in a world of inconvertible currencies is the difference both to producer and consumer whether payment is made in a hard or soft currency. Where trade involves a middleman, including in this case agents residing in third countries who receive a commission, part of the value of an internationally traded commodity is received by residents of a third country rather than by the producer and becomes a component of the income account of the balance of payments of the third country.

As a link between the country of production and country of final consumption, the middleman is one factor whose activities must be taken into consideration in the study of changes in the volume of world trade and the relation between the structure of trade and structure of production. In addition, the utilization of international trade and payments statistics for the assessment of the interregional financial position of a country or for the study of the structure of world trade requires an understanding of the effect of middleman activities on these statistics.

Economic Significance of Middleman Trade

What is known about middleman trade and its economic significance? There can be little doubt that, historically, middlemen made a major

[2]Some transactions involve several middlemen and their affiliates and, particularly in the case of petroleum trade, several currencies. Cornelius J. Dwyer gave me the following illustration of typical transactions of this nature: A shipment of oil from Saudi Arabia to Japan is paid for in pounds sterling, the Japanese purchaser paying Standard-Vacuum Ltd. in London. The latter then pays pounds sterling to its affiliates in Saudi Arabia for royalties and other local expenses, and transmits the profits in dollars to its American principal, Standard-Vacuum of New York.

contribution to the rise in volume of world trade and production as well as to the development of international credit instruments. Although most economic historians do not distinguish between direct and indirect trade of nations, it is clear that many major trading nations have been major middleman countries. For this there is evidence in the ancient periods of Mediterranean commerce when Crete, Phoenicia, and Greece each in its period of supremacy dominated much of world commerce. And the role of these trading states as middleman in expanding world trade, propagating techniques of production and new tastes in consumption is well known. In the early Christian era and until very recently, middleman activity was a major factor in the rise and decline of a succession of commercial nations. Constantinople, the Italian cities of Venice and Florence, and the German cities grouped under the Hanseatic League enjoyed periods of control of large proportions of world commerce. In the seventeenth century the Dutch established a virtual monopoly of European transport and commerce, and in the eighteenth century Great Britain became the great entrepôt of the world.

This is not to argue, however, that middleman trade was always a force for economic progress. Heckscher, in a study of mercantilism, distinguishes between a passive and an active staple policy in the middle ages.[3] Under the passive policy, an attempt was made to attract goods to a city by permitting freedom of entry for all merchants. The active policy (noted as more important) meant concentration of trading in the hands of native craftsmen, merchants, brokers, carriers, and shippers, and frequent use of force to ensure the passage of foreign merchandise through the hands of local merchants. Heckscher adds that, while commercial cities were of great importance as pioneers and leaders of medieval economic policy, their activities were sometimes harmful to world trade, at times even to trade of the staple center. Later, the growth of British commercial supremacy as an entrepôt center was associated with the Navigation Acts of 1660 and 1663 which were designed to make England ". . . a Staple not only of the Commodities of those Plantations [i.e. the colonies] but also of the Commodities of other Countries and Places for the supplying of them."[4] Whether or not these acts helped or hindered the rise of England to its commercial supremacy is a moot point.

In recent years middleman trade has been the subject of much comment – chiefly derogatory – but of little systematic study. The importance of the middleman to problems associated with inconvertible currencies was suggested by Sir Stafford Cripps who attributed in large part the 1949

[3]Eli F. Heckscher, *Mercantilism,* translated by Mendel Shapiro, 2nd rev. ed., Macmillan, 1955, Vol. 2, Chapters II and III.
[4]*Ibid.*, p. 71.

devaluation of the pound sterling to the intervention of nonsterling area merchants in the export trade of the sterling area.[5] Again, foreign middlemen, taking advantage of the 1955 discount on the pound sterling to compete in the sterling area trade, had a part in pushing the British government into supporting the transferable sterling rate which established informally *de facto* convertibility.

The significance of middleman trade for foreign exchange and national income of the middleman country has been made clear by the Bank of England; it attributes to the British merchant a role of fundamental importance in his direct contribution to the British balance of payments and also in the support he lends to other international activities of the United Kingdom.[6] As for his role in the structure of production and volume of world trade, case studies of British overseas territories have revealed that the middleman still plays an important role in the economic activities of these countries.

Concerning the problem of the utilization of trade and payments statistics for the study of the structure of world trade and payments, observations in the course of research at the National Bureau of Economic Research indicate that variation in the treatment of middleman activities in trade classification systems is a significant factor in differences between estimates of the magnitude of current interregional or intercountry balances reported by the exporting and the corresponding importing countries or areas for the same set of transactions.[7] Ignorance of the magnitude and structure of middleman activity may therefore lead to misinterpretation by governments of statistics of current balances. This problem may be intensified when one attempts to interpret world trade matrixes showing commodity and area detail,[8] since positive and negative discrepancies between the records of trading partner countries tend to cancel out with aggregation. However, the objective of the study must also be considered. As shown below, distortions resulting from middleman trade are much more serious for the study of commodity trade between areas or countries on a purchase-sale basis than on an origin-destination basis.

For these reasons, as one phase of the Study of the Structure of World

[5]See section 2, discussion of middleman trade and the international flow of currencies.

[6]*Bank of England Report, 1954,* p. 11.

[7]For an analysis of the problems of constructing a matrix of merchandise transactions between world areas and of the preliminary results for 1951, see Herbert B. Woolley's paper, "On the Elaboration of a System of International Transaction Accounts" (*Problems in the International Comparison of Economic Accounts,* Studies in Income and Wealth, Volume Twenty, Princeton University Press for National Bureau of Economic Research, 1957).

[8]See, for example, *Trade Intelligence Paper, No. 5,* General Agreement on Tariffs and Trade Secretariat, October 1955.

Trade and Payments undertaken by the National Bureau, it was considered worthwhile to carry out an investigation of international middleman trade.

Treatment of Middleman Trade in Systems of Country Trade Classification and Systems of Reporting Partner Countries

A few illustrations[9] of the treatment of various patterns of middleman trade in country trade and payments statistics[10] will serve to throw light on major patterns of middleman trade, problems of interpreting trade and payments statistics resulting from middleman activities, and problems of using trade and payments statistics provided by different countries for the study of middleman trade.

One pattern of middleman trade is the consignment and sale of a commodity by country A to country B followed by the reconsignment and resale of the commodity by country B to country C. Although it is not possible to determine from trade records when there has been a change in ownership, this is probably the typical pattern for the re-export trade of countries on the general trade system,[11] for example, British re-export of Malayan rubber to the United States. Reconsignment and resale are also generally involved in exports from entrepôt by countries on the special trade system, for example, the Dutch entrepôt trade in produce originating in the Far East and destined for Western Europe. Part of the produce that enters only transit trade records of middleman countries involves this pattern, as Brazilian exports of coffee to Western Europe

[9]A more formal analysis is provided in the Appendix.

[10]See *International Trade Statistics* (R. G. D. Allen and J. Edward Ely, eds., Wiley, 1953), Chapters 3 and 7, for definitions and discussions of methods of reporting partner countries and trade systems. Additional comments are given in a report of the group of experts on definitions for external trade statistics (*Principles for Statistics of External Trade,* United Nations E/CN.3/142, October 6, 1952).

[11]The general trade system records imports of goods when they fall under customs control either for entry into storage warehouses or for direct passage to the interior. Under this system exports are classified as domestic exports and re-exports, excluding offshore transactions and trade stated to be passing through in direct transit. The special trade system is a record of trade that is cleared through customs; in addition to the above exclusions, it excludes also imports stored in warehouses and re-exported without clearing customs — the entrepôt trade. Offshore transactions and entrepôt trade are probably primarily middleman trade as defined here, while direct transit trade may or may not include middleman trade. (For a fuller explanation, see *International Trade Statistics, op. cit.,* pp. 44-49.) It is not possible to measure all of the middleman trade that is reported by countries under either system. Re-exports are not always separately classified by countries using the general trade system, and part of their middleman trade may be included in the category called domestic exports. The problem of measurement is almost hopeless in the case of the special trade system since no distinction is made between domestic exports and re-exports which have cleared customs. The additional records kept by a few countries using this system are inadequate. This is discussed further in the Appendix.

which are transshipped to the United States. Because countries use different systems of reporting partner countries this pattern leads to discrepancies in their records. For example, in the postwar period the U.S., which reports imports by country of origin, has regularly had an excess of coffee imports from Brazil over Brazilian reported exports to the U.S.[12] For a small part of its coffee exports – averaging 17.4 thousand tons from 1946-1952 – Brazil reports Western Europe as its destination while the U.S. reports Brazil as its country of origin. Consequently, if the trade records of both the U.S. and Brazil are carried over to the balance of payments records without change to a purchase-sale basis, the interregional credit-debit balances of these countries will include the same discrepancy. In that case, the U.S. balance of payments record would be incorrect for transactions in which a middleman sells commodities imported by the U.S. while Brazil, which reports the middleman country as country of purchase, would have a more accurate record of sales than that of the country of consumption, the U.S., for this pattern.

A second pattern of middleman trade is the offshore sales[13] (merchandise transactions abroad). This is illustrated by much of the petroleum trade and by the sale of British East African coffee to the U.S. by British merchants with direct consignment of the coffee from British East Africa to the U.S.[14] Most trade records are not affected by offshore sales, but since few countries adjust their balance of payments records to a country of payment basis, errors occur in records of interregional balances of both producing and consuming countries.

Other patterns combine different features of these two basic ones. For example, some of the Indonesian rubber exports to Malaya are resold by British firms to third countries and consigned directly from Malaya. In this case, consumer importing countries, in many instances, report incorrectly both the country of origin and country of purchase.

In brief, because different systems of reporting partner countries are used, middleman trade leads to discrepancies between records of producing and consuming countries for the same transaction, reducing the usefulness of trade and payments records for the analysis of trade by purchase-sale or origin-destination, or both. In addition, records of middleman countries, using either the general or special trade system of classifying imports and exports, contain incomplete reports of middleman trade.

[12]*Estadisticas Cafeteras*, Pan-American Coffee Bureau, February 1954, Tables CC-5 and CC-28. See also the discussion, in section 3 below, of middleman trade in coffee.
[13]I use the term "offshore sales" to describe that part of middleman trade which does not involve a reconsignment by the middleman from his country of residence.
[14]For petroleum, see Cornelius J. Dwyer, "The Oil Trade in the International Balance of Payments in 1951," (mimeo, National Bureau of Economic Research, December 1955); for coffee, see the appropriate pages of section 3, below.

In the following sections, some use is made of re-export records and of Herman Karreman's thorough study of the entrepôt and transit trade records of the Netherlands providing information on the middleman activities of this major middleman country.[15] However, I have relied most heavily on the import records of seven countries – Germany, Denmark, Norway, Sweden, Finland, Yugoslavia, and Colombia – which provide records of imports both by country of origin and country of purchase.[16] Although these data must be used with qualifications and are available for only a few recent years, they provide a better aggregative record of middleman trade than other available sources do.

Plan of the Study

The data provided by the records of these seven countries are used in section 1 to measure the magnitude and concentration of middleman trade as it applies to countries viewed as final importing countries, as middleman countries, and as countries of production of internationally traded commodities. I describe, first, the magnitude of middleman trade in relation to total imports of these seven countries, the relative amounts of categorized commodities bought from middlemen by these seven countries, and the relative importance in this trade of the major middleman countries. These data are supplemented by the rougher quantitative and qualitative information that is available for other importing countries. The data provided by the seven importing countries are then used to indicate the proportion of middleman trade to total export trade of major middleman countries, the proportion of exports by areas and countries of production which are sold by middlemen, and the interrelation between countries of origin and middleman countries. These data are supplemented by an analysis of the Netherlands trade records. On the basis of this evidence, a rough estimate is made of world middlemen trade for 1952.

Section 2 describes the relative magnitude, structure, and trends in three components of middleman trade which have important economic and statistical implications: overseas territorial trade, trade of hard currency countries with soft currency countries, and entrepôt trade.

Section 3 is concerned with the question of the validity of trade and payments records for various types of economic analysis. And a hypothesis that middleman trade seriously limits the usefulness of these records is tested by a study of trade in four major commodities – petroleum, coffee, rubber, and cotton – for which data have been compiled on world

[15]Herman F. Karreman, "Dutch Merchanting Activities Revealed in Netherlands Trade Statistics, 1951" (unpublished manuscript, National Bureau of Economic Research, 1952).

[16]See footnotes to Table 1.

trade between countries, using both exporters' and importers' records for each transaction.

Section 4 gives the conclusions of this study, and, on the basis of the analysis, a critical examination of recent proposals put forth by the United Nations and the International Monetary Fund to improve the recording by countries of international trade statistics.

1. Evidence on Magnitude and Concentration of Middleman Trade in Relation to World Trade by Countries and Commodities

Middleman Trade in the Imports of Selected Countries

Tables 1, 2, 3, and 4 describe middleman trade in commodities purchased from, but not produced in, middleman countries by seven importing countries. Table 1 gives the value of their total imports from middleman countries; Tables 2 and 3 show the figures by a commodity breakdown; and Table 4 shows the relative importance of the major middleman countries in this trade.

In these tables, the excess of amounts purchased by the final importing country (I) from a middleman country (M) over the amount originating in country (M) is only a *net* measure of (I's) purchases from (M) of all other countries' goods. It is net because other middlemen may sell some of the produce of country (M) to (I). For two of the seven countries – Yugoslavia and Colombia – only these net measures were easily obtainable. For another two – Germany and Denmark – cross-classification tables are given so that completely gross data (total imports purchased from but not produced in middleman countries) can be obtained. And for the other three import data in broad commodity groups were used to get a partially gross record.[1]

As noted in the Appendix, both conceptual and practical problems are involved in the use of the concepts "country of origin" and "country of purchase," but these are less serious than the corresponding problems

[1] Obviously, the degree of grossness depends partly upon the fineness of the commodity classification available or feasible to use for the compilation of total excess of purchase over origin. Sweden provides commodity-country imports by country of purchase and country of origin for only 12 commodity groups; for Norway there